

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

ESTATE OF SAMUEL COHEN, DORA S. COHEN,  
ADMINISTRATRIX, AND DORA S. COHEN

**Appearances:**

Bor Appellants: Oliver R. Mills

For Respondent: Peter S. Pierson,  
Associate Tax Counsel

**O P I N I O N**

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board denying the claims of Estate of Samuel Cohen, Dora S. Cohen, Administratrix, and Dora S. Cohen for refund of personal income tax in the amounts of \$1,137.51 and \$654.78 for the years 1955 and 1956, respectively.

The question presented by this appeal concerns the propriety of certain expenses deducted by appellants and disallowed by respondent.

Prior to 1955 the now deceased Mr. Cohen and his wife, appellant Dora S. Cohen,, resided in Oregon. In that year they moved to California,, and Mr. Cohen opened an office in San Francisco, which he maintained for several months. In August 1955, he transferred his office to Beverly Hills, and remained there until his death on June 3, 1960.

During the years involved in this appeal, Mr. Cohen was an active investor in securities. After his death, delinquent joint returns were filed, reporting income from securities amounting to \$134,872.34 and \$47,736.43 for 1955 and, 1956, respectively. Cohen maintained stock accounts

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with numerous brokers located in Seattle, Portland, San Francisco, Los Angeles, Beverly Hills, New York, and Chicago. In addition, he did business with commercial banks located in most of those cities.

Prior to moving to California, Mr. Cohen had been engaged in the purchase and sale of heavy machinery in Oregon. During the years in question he attempted to re-establish that business here in California, and purchased business property in Culver City, which he anticipated using as a warehouse for heavy machinery. He made an attempt to become the majority shareholder in a New York corporation, and still held some 90,000 shares of that corporation's stock when he died in 1960. Mr. Cohen also negotiated to acquire a small electronics corporation, but abandoned the idea when he found that he could not purchase enough shares to gain control,

In pursuit of his various activities, Mr. Cohen incurred a number of expenses. In the joint returns which were filed, there were deducted expenditures totalling \$12,538.64 in 1955, and \$12,091.95 in 1956. Travel expenditures, including outlays for hotels, meals, air transportation, and auto rental fees, constituted the largest expense item. Among other miscellaneous expenditures listed, substantial amounts were attributed to office rent, telephone and telegraph bills, automobile expense, financial publications, and business gifts and entertainment;

The tax returns for 1955 and 1956 filed after the death of Mr. Cohen were audited by respondent. At the time of the audit, some of Mr. Cohen's cancelled checks for 1955 were missing, as were all the cancelled checks for 1956. After examining the records which were available, respondent disallowed 90 percent of the amounts deducted by Mr. Cohen for each year on the ground that the claimed expenditures had not been satisfactorily substantiated as ordinary and necessary business expenses. After a hearing respondent affirmed the proposed additional assessments it had made, and appellants paid the total amount assessed. This appeal is taken from respondent's denial of appellants' claims for refund,

Appellants were unable to produce any records of Mr. Cohen's expenditures in 1956, and respondent contends that his cancelled checks for 1955 are inadequate to substantiate the claimed expense deductions for that year because they provide no means of attributing the outlays made to specific business transactions, and they fail to distinguish between business and personal expenditures. Respondent further urges that those expenses which were incurred in connection with Mr. Cohen's attempt to re-establish his heavy machinery business in this state are, not, deductible as ordinary and necessary business expenses, because at the time they were incurred

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Mr. Cohen was not engaged in the heavy machinery business, but was merely investigating a prospective business for future operation,

Appellants contend that Mr. Cohen's cancelled checks for 1955 constitute adequate records to substantiate the expense deductions taken for 1955 and 1956. Though they have failed to produce any cancelled checks for 1956, appellants urge that the checks were available at the time the tax returns were prepared by Mr. Cohen's accountant, and that since Mr. Cohen's business activities were about the same in 1956 as in 1955, the cancelled checks for 1955 provide a reasonable basis upon which to make an approximation of his 1956 expenses. Appellants also argue that Mr. Cohen's efforts to re-establish his heavy machinery business in California did not constitute the start of a new enterprise, but were rather connected with the extension of an existing business, and that any expenses arising out of those efforts are therefore deductible as business expenses,

Section 24343, subdivision (a), of the Revenue and Taxation Code allows as a deduction "all ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business." Respondent correctly points out that expenses incurred in connection with the investigation and formation of a new business are not deductible under this section because no "trade or business" was being carried on at the time the expenditures were made. (See the following cases interpreting comparable federal legislation: Frank B. Polachek, 22 T.C. 858; Morton Frank, 20 T.C. 511.) The facts in the record indicate that Mr. Cohen attempted to form, but did not engage in a heavy machinery business when he and Mrs. Cohen moved to California, and appellants have failed to prove otherwise. In addition, there are in the record a number of cancelled checks drawn on Oregon banks which indicate that the Oregon business had been incorporated. Mr. Cohen signed those checks "Associated Machinery Co., Inc., By Samuel H. Cohen." This militates against a conclusion that in California he was merely continuing in his own, right a business which he had previously conducted as an individual in Oregon,

The expenditures incurred by Mr. Cohen in his attempt to gain controlling interests in certain corporations are not deductible as current expenses. They are outlays made in connection with the acquisition of capital assets, and they therefore constitute a part of the cost of the stock and are non-deductible capital expenditures. (See Cal. Admin. Code, tit. 18, §§ 17202(a), 17283(a), 17283(b), and 17252, subd. (n); Crowley v. Commissioner, 89 F.2d 715; James M. Straub, 13 T.C. 288; L. D. Blumenthal, T.C. Memo., Dkt. No. 89904, Sept. 30, 1963.)

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Appellants contend that about 80 percent of the expenses which Mr. Cohen deducted in his returns for 1955 and 1956 were related to his investment activities. They allege that in order to protect and manage his holdings, it was frequently necessary for Mr. Cohen to travel about to obtain financing, to buy and sell stock, or to otherwise do business with the brokerage houses and banks in which he maintained accounts. In addition, a number of these transactions were allegedly conducted by means of long distance telephone calls, or by telegram,

It is well settled that the management of one's personal investments, however extensive, does not constitute a "trade or business." (Higgins v. Commissioner, 312 U.S. 212 [85 L. Ed. 783]; Commissioner v. Smith, 203 F.2d 310, cert. denied, 346 U.S. 816 [68 T. Ed. 343]; Appeal of John and Eliza Gallois, Cal. St. Bd. of Equal., Dec. 10, 1963.) Expenses incurred in connection with such investment activities may be deductible, however, under section 17252 of the Revenue and Taxation Code, which permits the deduction of all ordinary and necessary expenses paid for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income.

It is true that Mr. Cohen's cancelled checks fall short of the desired standards for complete substantiation of alleged expenditures, for they fail to establish clearly that such outlays were either ordinary and necessary, or that they were proximately related to the management, conservation or maintenance of income-producing property. Respondent concedes, however, that a portion of the expenditures proven by the cancelled checks were properly deducted, e.g., those amounts expended for office rent. Recognizing that "something was spent," respondent has applied the rule derived from the case of Cohan v. Commissioner, 39 F.2d 540, and has allowed 10 percent of the deductions claimed for each of the years 1955 and 1956.

Items which may be deducted by a person managing income producing property include, in addition to office rent, the costs of investment counsel, telephone and telegraph, postage, office supplies, trips to look after investment properties, travel to and from brokerage offices, and similar expenditures. (Cal. Admin. Code, tit. 18, reg. 17252, sub d, (g); Raymond Fitzgerald, T.C. Memo., Dkt. No. 52539, Dec. 27, 1956; R. C. Coffey, 1 T.C. 579, aff'd on other grounds, 141 F.2d 204.)

Considering the volume and diversity of Mr. Cohen's investment activities, and the location in various cities and states of his brokerage accounts, it seems very likely that

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Mr. Cohen would have found it necessary to incur deductible expenditures in excess of the amounts allowed by respondent. He was not a mere passive investor, but appears to have actively participated in the management and maintenance of his investments. The cancelled checks for 1955 which are in the record prove that the amounts evidenced by those checks were, in fact, spent. They also provide us with a means of approximating Mr. Cohen's expenditures for similar purposes during 1956, even though the cancelled checks for that year are now missing.

We believe this is a proper case for application by us of the so-called "Cohan rule." Making what appears to us to be a more reasonable estimate, in view of all the facts of the case and the evidence which is before us, we conclude that appellants are entitled to deduct 50 percent of the expenses claimed in their income tax returns for the years 1955 and 1956.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the claims of Estate of Samuel Cohen, Dora S. Cohen, Administratrix, and Dora S. Cohen for refund of personal income tax in the amounts of \$1,137.51 and \$654.78 for the years 1955 and 1956, respectively, be and the same is hereby modified in accordance with the opinion of the board.

Done at Sacramento, California, this 17th day of November, 196, by the State Board of Equalization.

<u>Paul R. Leake</u>	Chairman
<u>John W. Lynch</u>	Member
<u>Ed. J. Perry</u>	Member
<u>Richard C. Blair</u>	Member
_____	Member

Attest

W. Freeman

Secretary